Gleiss Lutz

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TAX

THE 2018 COALITION AGREEMENT – CHANGES TO CORPORATE TAXATION

In their coalition agreement, the CDU/CSU and SPD have also agreed on changes to taxation. We set out below the changes planned that could affect companies.

I. Transposition of the EU's Anti-Tax Avoidance Directive

The coalition partners have agreed to transpose the EU's Anti-Tax Avoidance Directive in the area of hybrid mismatch rules, controlled foreign corporation (CFC) rules, and interest deduction ceiling rules.

Gleiss Lutz commentary
The Anti-Tax Avoidance Directive was resolved upon by the Member States with the aim of ensuring that tax is paid in a balanced way where profits and value are generated. The Directive's official grounds follow the BEPS recommendations published by the OECD in October 2015, which go back to an initiative by the G20. The Directive provides for a minimum level of protection which Member States cannot go below when transposing the Directive. As a general principle, Member States must transpose the Directive by 31 December 2018 (to take effect from 1 January 2019).

Large parts of the EU's Anti-Tax Avoidance Directive were modelled on already existing German tax laws. But some matters have remained largely unregulated to date, such as the issue of hybrid mismatches. Germany's Federal Government and the regional states have now put together a working group to review what needs to be modified in German tax rules in order to comply with the EU's Anti-Tax Avoidance Directive, and to work out corresponding proposals.

It appears that the following areas relevant to companies are going to be affected.

1. Hybrid mismatch rules

A key part of the EU's Anti-Tax Avoidance Directive are hybrid mismatch rules, whose implementation the coalition agreement expressly refers to.

Gleiss Lutz commentary
The Directive is intended to prevent discrepancies between various national tax systems from being exploited. To date, there have been barely any rules in the Member States to prevent such discrepancies. This applies to Germany as well. Section 8b(1) sentence 2 of Germany's Corporation Tax Act (*Körperschaftsteuergesetz*), for example, disallows tax exemption for dividends if the company paying out the dividend could claim the deduction as business expenditure. Like other provisions, this only ever covers a particular segment of the asymmetries that are possible. The aim now is for Member States to place the legally binding prevention of hybrid mismatches on a broad footing.

Under the Directive, typical tax congruency between two States includes double deduction of expenses, deduction of an expense without it being included in the recipient's income, or double offset of deductions at source (in different States). To avert such incongruence, the Directive provides for a particular mechanism to ensure that each item or matter falls under taxation at least once, and that tax deduction or offset is permitted only once. One thing that can therefore be expected is a major recast of the previous draft section 4(5a) of Germany's Income Tax

Act (*Einkommensteuergesetz*).

2. CFC rules

The coalition agreement provides for modifications to CFC rules such as to "give them a modern structure".

Gleiss Lutz commentary
Since 1972, Germany has had a comprehensive system of CFC rules in the form of sections 7-14 Foreign Tax Act (Außensteuergesetz). To adjust this system to meet the stipulations of the EU's Anti-Tax Avoidance Directive, a revision will be required, but its likely extent cannot currently be estimated. To date, German law has defined deleterious CFC income in an active catalogue, but the Directive now defines it in a passive catalogue. Whether the planned changes will result in tighter rules compared to current law remains to be seen. According to the coalition agreement, the EU Anti-Tax Avoidance Directive is to be transposed "in the interests of Germany as a place for business", which gives grounds to hope that balance will be maintained. It also appears that a reduction of the low tax load ratio – currently 25% – is under discussion as part of reforming the provision.

3. Adjustment to interest deduction ceiling rules

Finally, the coalition agreement also mentions a modification to interest deduction ceiling rules.

Gleiss Lutz commentary
Germany's national tax regulation in this respect was seen as the blueprint for interest deduction ceiling rules in the EU Directive. In our view, therefore, marginal changes at most can be expected in the German rules, and these may take the form of improvements compared with the status quo, by expanding the number of exemptions.

II. Expansion of real estate transfer tax in share deals

The coalition partners also wish to "implement a legally sound statutory rule to end abusive tax structures in real estate transfer tax through share deals".

Gleiss Lutz commentary
This refers to a reduction in the 95% limit in section 1(3) Real Property Tax Act (*Grunderwerbsteuergesetz*), likely to also apply to section 1(3a) of the Act, and possibly section 1(2a) of the same Act as well. It is not yet clear what exactly the new provision will be. It is doubtful whether grounds to take action have in fact arisen since section 1(3a) of the Act was introduced in 2013. But it appears that politicians have resolved to abolish structures currently possible that include an "RETT blocker" minority interest. A working group involving the Federal Government and the regional states has already been tasked with preparing and proposing a solution within the near future. As a quid pro quo, a tax allowance on acquiring residential property and a reduction in tax rates is being contemplated.

III. Introduction of a tax on financial transactions

According to the coalition agreement, a "substantial financial transaction tax" is to be introduced.

Gleiss Lutz commentary
A financial transaction tax has failed several times already on the European level. A tax of 0.01 to 0.1% is under discussion, based on stock market turnover. France recently suggested only subjecting share turnover to taxation, and excluding derivatives from such taxation. The main concern raised in relation to a financial transaction tax is that funds in the financial industry may migrate to states in which no such tax is due. This was one reason why the Swedish financial transaction tax was dropped in 1992 after having been introduced in 1985, another being that its revenue fell far short of expectations. The most recent state to leave the network of states contemplating the introduction of such a tax was Estonia. Doubts as to the introduction of a financial transaction tax are likely to have been exacerbated by the United Kingdom's impending exit from the EU.

IV. Tax incentives in research and development / innovation

The coalition agreement provides for tax relief on research and development, especially for small and medium-sized enterprises. There is also to be a review of whether depreciation tables should be revised in favour of digital innovation assets.

Gleiss Lutz commentary

The Federal Government has picked up a proposal by Germany's Commission of Experts for Research and Innovation (*Expertenkommission Forschung und Innovation - EFI*) to provide favourable tax treatment to research as additional project support. In contrast to other European locations, the German Federal Government has previously argued against introducing what are termed patent boxes with preferential tax rates. A tax incentive is now to be created, based on staffing and contractual costs. How exactly this will be structured remains to be seen, in particular whether not only small and medium-sized companies but also major enterprises will be able to profit from it. The coalition agreement is not clear about what "digital innovation assets" is supposed to mean. Such measures will in any event, however, help make Germany a more attractive place for business.

V. Support for start-ups and venture capital

This also applies to how attractive Germany is for start-ups. The idea is for new companies to profit from eased administrative rules on VAT, including an exemption in the first two years to the duty to deliver a monthly advance self-assessment. Venture capital conditions are to be improved as a whole, and procedures for applications, approvals and taxation simplified. The statutory goal is to create a one-stop shop in which it is possible to complete all bureaucratic steps at one competent body.

Gleiss Lutz commentary

The measures planned are to be welcomed. In the last legislative period, it was found at sessions of the Bundestag's finance committee that there is relatively little venture capital investment in Germany compared to other countries. One step that has already been taken in this regard is the introduction of section 8d Corporation Tax Act (an exemption to the demise of the loss carryforward pursuant to section 8c of the Act). Further improvement to framework conditions provides hope that there will be positive effects on the investment climate in Germany.

VI. Initiative with France – harmonization of taxable base and rate for corporate taxes

A final goal is to realize a standard economic space with France in corporate and bankruptcy law as well as to harmonize taxable base and minimum rates for corporate income tax. On the European level as well, and in concert with France, such harmonization is desired. The Franco-German initiative is a European answer to changes and challenges on the international scene, not least from the US.

Gleiss Lutz commentary

European attempts to create a Common Consolidated Corporate Tax Base (CCCTB) have thus far run into the sand, so it remains to be seen whether a bilateral approach with France will bear fruit. The aim is to deepen and continue the process of harmonization within Europe. The coalition agreement's perspective on the US shows that the tax reform there and reduction in corporate taxes is being taken seriously. So it is to be hoped that European politicians can also agree to a tax rate below the magic figure of 30%.

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